

Department of Veterans Affairs
Washington, DC 20420

VA HANDBOOK 4560.1
Transmittal Sheet
December 13, 1995

COST ACCOUNTING HANDBOOK

1. REASON FOR ISSUE: To revise Department of Veterans Affairs (VA) Cost Accounting procedures formerly contained in MP-4, Part V, Chapter 6, Cost Accounting.

2. SUMMARY OF CONTENTS:

a. This handbook introduces a new methodology by which VA will cost the acquisition and/or production, management, and delivery of its products and services to a customer.

b. It identifies responsibilities for Departmental costing methodology, handbook development, and review.

3. RESPONSIBILITY OFFICE: Cost Accounting and Medical Rates Division (047GC2), Office of the Associate Deputy Assistant Secretary for Financial Policy (047G).

4. RELATED DIRECTIVE: VA Directive 4560.

5. RESCISSION: MP-4, Part V, Chapter 6, Cost Accounting.

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FOREWORD

COST ACCOUNTING

1. The cost accounting policy of the Department of Veterans Affairs (VA) has been developed to fulfill four functions:
 - a. Enable VA's Chief Financial Officer (CFO) to comply with the specifications and requirements of the Chief Financial Officers Act of 1990, P.L. 101-576 (CFO Act);
 - b. Provide a basis for developing fees and charges which accurately reflect all costs incurred to the Government in providing those products and/or services which are reimbursable by other parties;
 - c. Provide a tool for managers in evaluating their organizations and understanding its cost structure; and
 - d. Maintain a certain level of consistency in its costing approach which will allow VA to aggregate data while encouraging flexibility depending on the cost objective(s).
2. To achieve these goals, the policy is product oriented and, wherever possible, actual costs must be directly linked to production units. As outlined in this Foreward, VA administrations and staff offices are required to develop and maintain a current list of the products they produce (including all services or types of services rendered). The charge(s), if any, made for those products, and the cost figures used by the organization which compose the charge(s) shall be documented.
3. The purpose of identifying products, charges, and cost figures is to comply with the CFO Act, which states: "An Agency Chief Financial Officer shall develop and maintain an integrated agency accounting and financial management system including financial reporting and internal controls, which provides for the development and reporting of cost information." (P.L. 101-576; 902.(a)3.(ii))
4. Furthermore, "An Agency Chief Financial Officer shall review, on a biennial basis, the fees, royalties, rents, and other charges imposed by the agency for services and things of value it provides, and make recommendations on revising those charges to reflect costs incurred by it in providing those services and things of value." (P.L. 101-576; 902.(a)(8)). This review is the responsibility of the Cost Accounting and Medical Rates Division (047GC2), Office of Financial Policy, Office of Financial Management.
5. Responsibility segments, (See Glossary) significant organization, operational, functional, or process component should be capable of measuring outputs at full cost. The full cost is the sum of the costs of resources consumed by the responsibility segment that directly or indirectly contribute to the outputs, and the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and other reporting entities. (See Section B.)
6. This document outlines the basic structures and rules that VA will use to determine "full cost." As such, it offers basic definitions and guidelines. In only two areas are

procedures specified: building valuation, capitalization and depreciation; and step down cost allocation. (See Section C 5)

7. The rationale for prescribing building capitalization and depreciation is that while goods, services, missions, and basic configurations of duties and responsibilities may change from VA Administration to Administration and from Office to Office, the way in which VA costs buildings is to be uniform throughout VA. However, this methodology should be flexible and site specific, so that each building can be costed and depreciated locally, reflecting local costs and conditions. The methodology presented achieves these goals without overburdening responsibility segments with cumbersome calculations.

8. The rationale for prescribing the use of the step-down methodology for multiple cost allocation is based on the need for consistency with cost allocation and ease of calculation. Every multiple cost allocation method has its drawbacks as well as its strengths. Choosing one method will reduce confusion regarding the validity or margins of error of the figures generated between sites and provide uniform direction for those offices or Administrations which will or are in the process of creating, purchasing, or upgrading cost accounting systems.

9. In all other areas, this document is to be used as a parent document from which the Chief Financial Officer or comparable office within a VA Administration or Staff Office will develop more detailed and specific procedural manuals in accordance with the needs of their responsibility segments. As such, the guidance contained in this document provides a framework on which others can build as they deem necessary. This handbook is general in nature because of the vast differences in missions and organizational structures of the Administrations and offices within VA. While all VA entities will be required to reconcile cost accounting data to balances in general ledger accounts, those entities will be encouraged to choose cost accounting methodologies which best fit their organizations, business practices, and missions.

SECTION A. GENERAL

1. INTRODUCTION

a. This chapter prescribes the cost accounting policy of VA. The policy positions VA to take full advantage of existing, new, and emerging sources of operating revenues. Accounting for all expenses and revenues through a cost accounting methodology based on a unified and systematic cost accounting policy will provide VA a realistic basis for costing products and services. The flexibility to merge all income sources and track them by facility will provide VA the accounting base necessary to adequately meet the various demands of the future. The objectives of the cost accounting methodology are to:

(1) Define costs incurred by VA;

(2) Assign costs in a manner consistent with accepted (cost) accounting principles;

(3) Provide parameters for technical review;

(4) Facilitate both day to day and long range planning.

b. A uniform method of cost accounting is prescribed to obtain cost data in a manner which will ensure meaningful aggregation and comparisons. Policies are prescribed only to the extent necessary to ensure the compilation and reporting of such uniform data. The purpose of this policy is to create national uniformity in cost accounting principles and this policy permits local flexibility, allowing Administrations and staff offices to undertake individual programmatic changes in response to their individual missions while offering them guidance so the accounting of those programs will conform to national standards. The cost accounting policy provides sufficient flexibility to permit maximum adaptation to varying conditions existing at all operating levels.

2. SCOPE AND APPLICABILITY: A cost accounting methodology must be maintained for all stations and activities.

3. RESPONSIBILITY

a. The Fiscal/Financial Officer is responsible for the development and maintenance of the cost accounting system (either automated or manual), in accordance with local requirements within established VA accounting policies. In matters pertaining to the CFO Act and cost accounting policy, the Fiscal/Financial Officer takes direction from the Administration's CFO, who in turn receives direction from the VA CFO. The delegation of authority from the Office of the Secretary has designated the Assistant Secretary for Management as the VA CFO. The Office of Financial Management, Office of Financial Policy, Cost Accounting and Medical Rates Division is responsible for certifying to the VA CFO that any charges made by VA do in fact include all costs to VA associated with the delivery of the product or service.

4. COST ACCOUNTING PRINCIPLES

a. The VA cost accounting methodology encompasses all areas of revenues and expenditures (i.e., final costs incurred) including operating expense, income, acquisitions, and overhead.

b. The VA cost accounting methodology requires identification and assignment of all costs for products and/or services.

c. The VA cost accounting methodology allows for comparisons between the cost of products and/or services provided by VA and those provided by other Government agencies or on the open market.

d. Detailed income, expense, asset acquisition and maintenance cost, inventory, and building accounts are to be maintained and reconciled with related general ledger accounts.

- e. The cost accounting methodology identifies and assesses a responsibility segment's total capacity, readiness capacity, operating capacity, and their related costs.
- f. The basis for all amounts used in the VA cost accounting methodology is the VA accounting system. The methodology develops costs which accurately reflect VA expenditures without regard to funding mechanisms.
- g. All VA costs, without regard to funding mechanisms or organizational segregation, are costed to a product or service, or product/service line, either directly or indirectly.

SECTION B. COSTS

1. BASIC PRINCIPLES

- a. A full costing methodology is necessary to accurately determine the costs of the products and services a responsibility segment supplies to others, including other Government agencies, private industries, companies, and individuals. In light of legislation such as National Performance Review (NPR), the CFO Act, and possible changes in the national health care arena, it is vital that VA be able to accurately account for the public and private resources it consumes and accurately bill for the products and services it provides.
- b. Additionally, entities which receive products or services from other Government entities, within and outside VA, will need to reflect as a part of their cost of doing business the cost of the products and services they receive. Each entity's full cost incorporates the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services. Regardless of whether a transaction for a product or service is reimbursed, its cost must be determined and communicated.
- c. As mentioned in Section A, each responsibility segment will need to identify the products and/or services it delivers. A responsibility segment is defined as a significant organizational, operational, functional, or process component through which a mission is performed, output is generated, or measurable costs are associated.
- d. The determination of costs follows a number of steps as applicable to the products and/or services that are provided by an organization. The steps necessary may include all or some of the following:
 - (1) All VA administrations and offices must identify responsibility segments.
 - (2) The responsibility segment must then determine if it produces a distinct product and/or service, or line of products or services, or if it should be classified as "overhead" (See Section D).

- (3) Each responsibility segment must identify all responsibility centers under its direction, and must then determine if the units produce a distinct product and/or service, or line of products or services, or if it should be classified as "overhead" (See Section D).
- (4) The costs associated with the acquisition, management, and delivery of those products and/or services must be identified. In the case of VHA responsibility centers providing medical care, this would include identifying the resources that are consumed in the provision of each intermediate product or procedure.
- (5) The costs must be categorized as Direct Costs, Direct Overhead Costs, or Overhead Costs.
- (6) An accounting system (automated or manual) to track those costs must be in place. It must capture all costs associated with providing a product or service to a customer.
- (7) With concurrence from the VA CFO, Administration CFOs or the senior executive of the administration or staff offices who do not have a designated CFO will have the responsibility of further standardizing, defining, regulating, and monitoring the identification of costs as direct, overhead, or other standard cost accounting variable which delineates costs beyond those specified in this document (such as variable and fixed). The methodology chosen must create a sufficient degree of standardization throughout the administration (or staff office), must be based on and balance with the VA accounting system, (general ledger) and be integrated into a national roll-up of costs in such a way as to provide correct, accurate, timely, usable, and comparable data.

2. DETERMINING STATUS

- a. The first step is to determine if a responsibility center (such as a medical center or the Office of Congressional Affairs) produces a distinct product and/or service, or a line of products or services, or should it be classified as national, departmental, regional, or local overhead. A responsibility center is defined as: An organizational unit headed by a manager or group of managers who are responsible for its activities. (example: Segment = VHA, Center = Medical Center)
- b. If the responsibility center does, in fact, produce a product or service, or one or more lines of products or services, as in the case of a medical center or Veterans Benefits field office, then that responsibility center would not be considered "Overhead." Only those responsibility centers which meet the criteria outlined in Section D, National, Departmental, Regional, or Local Overhead, will be allowed to be costed as VA overhead.

3. IDENTIFYING PRODUCTS AND/OR SERVICES

- a. Those responsibility centers which deliver products and/or services must then identify each responsibility segment and the products/services it provides. In the case of a VBA claims office, the services may include processing claims or responding to customer

inquiries. The products/services will be consistent with the mission of the organization. In the case of a medical center, a product may include a laboratory test, a medical ward bed day, a counseling session, and/or a magnetic resonance imaging procedure.

b. The goal is to identify the product or service at the level in which the product or service is rendered to a requester, be that an internal customer such as a clinic or a Regional Office, or an external customer such as a veteran applying for student benefits, another health care provider, or a Health Insurance Plan Provider. Standardization of identified products/services within an administration is the purview of the administration CFO or the senior executive of the administration or office which has no CFO. Such determinations are subject to review by the VA CFO.

4. COSTING PRODUCTS/SERVICES. The costs associated with the acquisition, management, and delivery of those products and/or services must be identified. The cost elements" are defined in Section C, Cost Elements.

5. CATEGORIZING COSTS. This section is offered as a guideline for developing categories for costs. Detailed information concerning the categorization of specific costs will be the purview of the Departmental (VHA, VBA) Chief Financial Officers (CFOs) or the office or administration senior executive for entities which have no CFO, with the concurrence of the VA CFO.

a. Direct

(1) A Direct Cost Area is a service or entity which supplies an identifiable product or service. (example: Surgical Service, Pharmacy Service, Neurology Service, Laboratory Service, distribution of a burial flag or a home loan).

(2) Direct costs are those costs which are directly associated with a product or service. These are costs that can be discretely and confidently identified to one particular product or service. As many costs as possible should be costed as direct costs so that resources expended toward that product or service are attached only to that product or service and not spread to products or services which are not benefiting from the resources.

(3) Direct costs include all labor costs directly associated with the delivery of that product or service.

(4) Direct costs include equipment that is used solely and identifiably for one or a discrete number of products or product lines. The purchase price, either expensed or depreciated, maintenance, and repair of the equipment would be a direct cost against the product(s) or service(s) for which exists.

(5) Direct costs include supplies and contracted services. If an entity purchases supplies, items, or services which it expends in the generation of identifiable products or services, or which it then passes on as a product, those costs are considered direct costs.

b. Overhead

(1) An overhead cost area is a Service or entity which supports a direct cost area but is not directly involved with or related to supplying the identified product(s) or service(s). Overhead includes, but is not limited to: Grounds Management, Acquisition and Materiel Management Services, Plant Operations, and Security Services.

(2) Overhead costs are those costs which are expended as a general, fractional and/or administrative support of a product or service but cannot, either fully or partially, be costed directly to any one product or service.

(3) Overhead costs include all labor costs associated with the support or infrastructure needed to maintain the entity in its delivery of products or services.

(4) Overhead costs can include equipment. If a piece of equipment is used to enhance the overall performance of a facility or operation and is primarily used by a group which is classified as overhead, the equipment, depending upon its value, would be fully costed or depreciated as overhead.

(5) Overhead costs can include supplies and contractual services. Any supplies or contractual services used by a responsibility segment defined as overhead, or expended in the performance of the mission of a responsibility segment defined as overhead, should be costed as overhead. Additionally, supply costs which cannot be directly applied to a product or service are to be considered overhead.

c. Direct Overhead. Direct overhead costs are those costs areas defined as overhead, but which should only be costed to direct or selected direct costs rather than being allocated to all areas, both direct and indirect. For example, direct overhead costs for the Surgical Service in VA Central Office should be allocated only to the surgical services at the various VA Medical Center's and not allocated to any other service.

6. APPLICATION OF COSTS

a. The Administration or office CFO, or the senior executive of the Administration or office which has no CFO, with the concurrence of the VA CFO, will be responsible for categorizing each responsibility segment as direct, or overhead. This will include creating of the order by which direct overhead and overhead costs will be applied to direct units or segments using the "step-down" method, except for the first overhead segment. In every case, the first overhead segment will be building capitalization and depreciation.

b. Each Administration or office will maintain a prioritized listing of the indirect and directoverhead segments and units in order of their allocation, and the direct segments or units to which the overhead and direct overhead segments or units are being allocated. The allocation sequence will be standardized within an Administration or office.

c. Additionally, the method of allocation (square feet, FTE, dollars, etc.) for each overhead and direct overhead segment will be noted. This list must be maintained in an up-to-date fashion. Any additions or changes to the order used in the step down methodology must be concurred in by the Administration or office CFO, or the senior executive of the Administration or office which has no CFO, and the VA CFO.

7. RECONCILIATION TO ACCOUNTING SYSTEM: At a minimum, expenses detailed in the cost accounting methodology must be reconciled to the cost (expenses) recorded in the general ledger of the VA accounting system.

8. ENSURING/VERIFYING COST OF PRODUCTS/SERVICES

a. It is the responsibility of the Administration or office CFO, or the senior executive of the Administration or office which has no CFO, with the concurrence of the VA CFO, to maintain and document a full cost accounting methodology which ensures that the full cost to the Government of providing a product or service to a customer is reflected in the price of or charge(s) made for that product or service unless otherwise authorized by legislative authority.

b. It is the responsibility of the VA CFO, upon the advice of the Cost Accounting and Medical Rates Division, Office of Financial Policy, to certify to the Secretary of Veteran Affairs, that the full cost to the Government of providing a product or service to a customer is reflected in the price of or charge(s) made for that product or service.

SECTION C. COST ELEMENTS

1. DESCRIPTION

a. When calculating the cost(s) of a product and/or service, all the cost elements which make up a product or service cost(s) must be identified. Some of these costs are easily identified, but others are more nebulous. For example, it is apparent that when costing delivery of educational benefits, one must take into account the Education Benefits Counselors, their desks and supplies, and their equipment needs. In the case of an X-ray, the equipment, technician, film, and film development would be a part of costing for the delivery of this product.

b. However, in both instances, an accounting must be made for electricity and heating, ventilation, and air conditioning costs, the share of the cost of maintaining rest rooms, meeting rooms, break or lunch rooms, regional, and national IRM (Information Resources Management) support. It is not enough to consider "some" or "most" costs when calculating the cost of a product or service; nor can such consideration be limited to "local" costs. All costs incurred by VA shall be considered when calculating product/service costs.

c. The Administration CFO or the senior executive of the Administration or office which has no CFO, with concurrence from the VA CFO, will have the responsibility of further

standardizing, defining, regulating, and monitoring the identification of cost elements. However, any such further breakdowns must be standardized throughout the Administration (office), must be based on and balance with the VA accounting system (general ledger), and must be integrated into a national roll-up of cost elements in such a way as to provide correct, accurate, timely, usable, and comparable data. What follows is a general breakdown of cost elements which will be considered when calculating costs and their general rules of application.

2. LABOR. Labor costs are defined as all funds expended for the people employed by an entity to conduct its business (providing a product or service). Labor costs include:

a. Gross salaries and/or wages earned in performance of the function(s) for which that person was hired (including all of the various premium pay items and benefits' costs such as health insurance and retirement);

b. Benefits accrued by the person, such as insurance and retirement benefits (above and beyond the gross salary or wages) may be expressed in terms of a percentage of gross salary or wages. The Office of Management and Budget publishes each fiscal year the average percentage of gross salary or wage paid by the Federal Government in earned benefits. This percentage shall or can be used to calculate the cost of labor for those individuals receiving benefits.

c. Wages paid through contractual agreements for persons employed by the entity to perform functions which are essential to or contribute to the delivery of a product or service will be costed as labor. (For example, VAMC personnel engaged in direct patient contact, such as residents or other medical personnel who provide patient services through contracts, sharing agreements, or any other arrangement.)

NOTE: Wages paid through contracts for support services such as construction, HAVOC equipment maintenance, or waste management shall not be classified as labor. These costs will be included in appropriate service or entity costs such as "building," "engineering service," or "environmental service" costs.

d. Within the VA system there are numerous volunteers providing services, a value-added activity, that contributes to customer value and/or satisfies overall organizational needs. Costing of volunteer labor is vital when the work accomplished by the volunteer is equivalent to a paid employee. In order to show true value of a product or service delivered by VA, volunteers who contribute to delivered products or services will be costed to those products or services.

(2) Volunteer costs will be computed and allocated at a minimum annually, on the basis of the prior year gross costs to all entities (responsibility segments, products or services) which benefited from the volunteer's service. The labor shall be costed and reported separately and should include the responsibility segment level on all managerial reports. For managerial purposes, these costs should also be shown as a separate cost item at the product or service level.

3. Training and Education expenditures

4. Travel expenditures

3. SUPPLIES AND SERVICES. To the extent possible and feasible, supplies and services will be assigned directly to the product or service area which expends those supplies or utilizes those services. All other supply and service costs are to be allocated based on a recognized full cost accounting allocation methodology.

4. EQUIPMENT

a. All equipment will be fully costed (either expensed or depreciated in accordance with existing VA Policy).

b. Once a piece of equipment has been fully costed, it can no longer be shown as an expense to the organization. However, any ongoing or recurring costs associated with that equipment, such as maintenance and supplies needed to operate the equipment, will continue to be expensed and shown as a cost for as long as the equipment is in use.

c. Equipment shall not be costed until it is placed in service. If a newly acquired piece of equipment remains idle or warehoused, or for any other reason is not put directly into use, the equipment shall not be costed until such time as the equipment is utilized.

d. If a piece of equipment is transferred to another responsibility segment within the entity which purchased the equipment and that equipment has not been fully costed, the remaining balance will be assigned to the responsibility segment or area to which the equipment has been transferred.

(1) The national organization shall maintain monthly records of the equipment containing:

a. The originating entity (or entity which purchased the equipment);

b. The disposition of the equipment (name and date of the entity to which the equipment was transferred, date and method of disposal, etc.);

c. The balance (in both dollars and term remaining to be expensed/depreciated) remaining for that piece of equipment;

(2) The national organization shall:

a. Expense/depreciate a given piece of equipment and incur the expense until that equipment is fully costed.

b. Cost the expensed amount as an operating overhead to the entities under its jurisdiction.

(3) All distinct and identifiable maintenance costs shall be costed against the equipment which benefits from that maintenance. Labor specifically acquired on a limited time or basis for maintenance of specific pieces of equipment, as in "service calls" made by non-VA employees, shall also be costed directly to the equipment which benefits from that maintenance. Maintenance costs, including maintenance contracts let against that equipment, will be calculated by fiscal year (prorated, if necessary) and added to the cost of the equipment for that fiscal year.

(4) Supplies purchased for that equipment without which that equipment cannot fulfill the function(s) for which it was purchased shall be added to the cost of the equipment on a fiscal year basis.

(5) All costs associated with a piece of equipment must be allocated/assigned to the product or service which utilizes the equipment in the delivery of that product or service. That product or service may change over the life of the equipment.

(6) If a piece of equipment is used in the delivery of more than one product or service, the costs must be fairly and accurately allocated/assigned to each product or service which utilizes the equipment.

(7) The methodology for allocating/assigning all costs associated with a piece of equipment will be determined by current financial management policies, directives and/or handbooks.

5. BUILDING VALUATION, CAPITALIZATION, AND DEPRECIATION

a. All buildings (structures which are permanently affixed to the land) owned by VA will be costed at acquisition or construction value and depreciated in accordance with current financial management policies and guidelines.

b. Within 1 year of the adoption of this policy, the Director or Senior Executive of each VA owned and operated office or facility will be responsible for certifying, upon the request of the VA CFO, that all records and calculations relating to building valuation, capitalization, and depreciation are up to date and accurate in accordance with current VA policy.

In the case of two or more entities that reside in the same VA owned and operated space, the Director or Senior Executive of the entity which utilizes the largest amount of space shall have the responsibility for ensuring that all records and figures relating to building valuation, capitalization, and depreciation are current and accurate.

c. In the case of VA occupied leased space, the full, annualized lease (or rental) amount will be used in arriving at "cost" regardless of whether the facility or the land on which it rests belongs to a Governmental entity or private concern.

d. The cost of leasehold improvements will be recognized by amortization of the leasehold improvements over the benefit period (the period of time which VA will benefit from those improvements). The leasehold improvements will be amortized over the remaining life of the lease or the remaining estimated economic life of the improvements, whichever is less. However, under no circumstances will leasehold improvements be amortized for a period longer than 40 years, even if the useful life of the improvement is greater than 40 years.

e. All temporary buildings will be valued at either the original acquisition or construction price and depreciated over the term of the lease or the life of the temporary structure, or at their annualized rental or lease amount.

f. The depreciated value of the building(s) or office space is to be calculated and allocated at a minimum monthly.

g. Depreciated value is adjusted accordingly within 10 work days after the formal acceptance by VA of a capitalized improvement, depreciation should be adjusted or begin when the asset is put into service.

h. Allocating Depreciated Value.

(1) Building capitalization and depreciation costs will be shown as its own category of cost and allocated to all departments, services, responsibility segments or centers, or production units.

(2) In the event that one entity includes more than one building (such as a campus style VA medical center), each building's depreciation expense will be calculated, and reported separately.

(3) A building's depreciated expense will be allocated based on square feet to the responsibility segments or centers occupying the building.

(4) When calculating the number of square feet in a building, actual usable floor space will be costed to the responsibility segments or centers, or production units which use the adjacent space.

(5) Corridor space such as hallways and stair wells will be allocated to Engineering Service or Environmental Management Service, or in entities which do not support Engineering or Environmental Services, this space will be allocated to the senior executive's office, to be further allocated to all departments, services, responsibility segments or centers, and production units.

(6) Crawl spaces or interstitial spaces which carry conduit, cable, pipe, or other maintenance features which must be periodically accessed for maintenance and repair will be charged to Engineering Service (if the entity supports an Engineering Service) or to the senior executive's office (if the entity does not support an Engineering Service).

(7) Unusable space, such as attics in older buildings or condemned or uninhabitable structures which are not and cannot be used for any practical purpose will not be counted, costed, or allocated.

6. UTILITIES: All utilities' costs must be fully allocated. In cases of extraordinary utility costs incurred in the production of a discrete number of products or services, those costs must be allocated to those products or services. However, in the majority of cases, utilities will be allocated based on an appropriate allocation methodology. (example: Square Feet (Sq. Ft.) or FTE)

7. CAPACITY: Capacity refers to the resources such as buildings, facilities, beds, wards, personnel, supplies, equipment, and stockpiles which are available to VA to fulfill its missions.

a. All Federal entities are required to track, cost, and report total and readiness capacity.

b. Total capacity is the entire operating capacity of an entity. Total capacity must equal the sum of Readiness Capacity and Operating Capacity (see below).

c. Readiness Capacity is capacity reserved for national emergencies. All costs associated with readiness capacity will be reported separately. None of these costs (including maintenance and materiel management) will be allocated against any other product or service. When readiness and operating capacity are commingled (as in the case of materiel, equipment usage, or space utilization), every reasonable effort must be made to fairly assign costs. If a cost object contributes to a product or service which is provided as a normal part of doing business and expended other than in emergency or mobilization situations, it is then considered a part of used capacity and the cost of that contribution must be allocated against the product or service being rendered.

d. Operating capacity is all other capacity (other than readiness capacity) that an organization has at its disposal.

SECTION D. OVERHEAD

1. BASIC PRINCIPLES: In this cost accounting methodology, as many costs as possible are linked either directly or indirectly to specific products or services. Some functions, however, are not amenable to direct product or service costing. These functions are costed as "Overhead."

2. TYPES OF OVERHEAD: There are six types of overhead;

a. "VA Wide Overhead" includes those centrally organized functions which serve all VA organizations.

b. "Administration Overhead" includes those centrally organized functions which serve only one VA administration or staff office (such as Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), or National Cemetery System (NCS)).

c. "Function Specific National Overhead" includes those centrally organized functions which serve a specific organizational unit which in turn generates a distinct, billable product(s) or service(s). For example, VA Central Office Pharmacy Service provides national support for all Pharmacy Services. Pharmacy Services have identifiable products and services. Therefore, all costs associated with the VA Central Office Pharmacy Service and its programs and operations would be costed only to all VA Pharmacy Services.

d. "Regional Overhead/VISN" includes those regional or multi-facility administrative offices which serve to support the facilities in their areas.

e. "Local Overhead" is defined as one facility's support of another, usually smaller, office. Normally, these offices are in close geographic proximity to the supporting facility; however, that need not be the case. Local overhead should not be confused with internal, indirect costs. To be considered local overhead, the supporting and receiving entities must be discrete entities, each identified separately in VA's accounting system (general ledger), each identifying and costing its own products and services.

f. "Internal Overheads" include those support or administrative offices or services within a facility. Internal overhead entities function in support of responsibility segments which in turn produce a product or service or which in turn support other internal overhead entities and offices.

3. VA-Wide National Overhead. The criteria for a service, division, office, or other organization being classed as VA wide national overhead are as follows:

a. The entity produces no distinct, billable product or service for any person, service, or organization to which its expenditures could be directly attached; and

b. The entity in the normal course of business serves all VA. VA wide national overhead costs are calculated at a minimum annually on the basis of prior year (or time period) gross costs to all entities which produce a product or a service. This allocation is based on an appropriate statistical basis to be determined by the VA CFO and accomplished at the highest possible level. For example, a national entity would allocate its gross expenditures to the administrations and offices which it serves. Those administrations and offices would, in turn, fairly and reasonably allocate those costs to themselves and to those for whom they have responsibility. (VHA to the VISNs, VAMCs, and clinics; NCS to its offices and sites).

4. ADMINISTRATION OVERHEAD

a. The criteria for a service, division, office, or other organization being classed as administration overhead are as follows:

(1) The entity produces no distinct, billable product or service for any person, service, or organization to which its expenditures could be directly attached;

(2) The entity in the normal course of business serves one administration or office (such as VHA, VBA, or NCS).

b. Administration overhead costs are to be calculated annually and allocated monthly on the basis of prior year (or time period) gross costs to all entities which produce a product or a service. The allocation is spread over the current year's (or time period's) costs for that entity. This allocation is based on an appropriate statistical basis (such as FTE or dollars) determined by the administration CFOs or the senior executives of the administrations or offices which have no CFO, with the concurrence of the VA CFO, and accomplished at the highest possible level. For example, the Office of the Undersecretary for Health will allocate its costs to all the VHA organizations or responsibility centers it serves, including VAMCs and VHA Regional Offices.

5. FUNCTION-SPECIFIC NATIONAL OVERHEAD

a. The criteria for a service, division, office, or other organization being classed as function specific national overhead are as follows:

(1) The entity produces no distinct, billable product or service for any person, service, or organization to which its expenditures could be directly attached;

(2) The entity in the normal course of business serves a specific VA office, service, or organization.

b. Function specific overhead costs are to be calculated annually on the basis of prior year (or time period) gross costs to the specific organization, service, or office it serves. (For example, VACO Pharmacy Service will allocate its costs to all field Pharmacy Services.)

c. The calculation method shall be based on an appropriate statistical method determined by the administration CFO or the senior executive of the administration or office which has no CFO, with the concurrence of the VA CFO.

6. REGIONAL/VISN OVERHEAD

a. The criteria for a service, division, office, or other organization being classed as regional overhead are as follows:

(1) The entity produces no distinct, billable product or service for any person, service, or organization to which its expenditures could be directly attached; and

(2) The entity in the normal course of business supports several or many other entities, usually geographically located within a defined region. (Note: "Region" is smaller than a national VA organization and can be used to indicate any current VA organizational structure larger than an individual facility or facility cluster, such as a VAMC and its satellite clinics and operations.

b. The calculation method shall be based on an appropriate statistical method determined by the regional director and the administration CFO or the senior executive of the administration or office which has no CFO, with concurrence by the VA CFO.

7. LOCAL OVERHEAD

a. The factors for determining if a service, division, office, or other organization will be classed as local overhead are as follows:

(1) The entity produces no distinct, billable product or service for any person, service, or organization to which its expenditures could be directly attached;

(2) The entity in the normal course of business supports one or several sites, facilities, offices, clinics, services, programs, or other discrete entities, usually smaller and usually geographically clustered around the supporting entity;

(3) The costs and products of the entity being supported are accounted for separately and distinctly from the supporting entity and are not a part of the direct or indirect costs of the supporting entity;

(4) The entity being supported is not a department, service, function, office, division, or other adjunct of the supporting entity;

(5) The entity being supported maintains a revenue stream separate and distinct from the supporting entity.

b. Local overhead entities will cost resources expended in support of local entities against the specific entities it serves. Local overhead costs are calculated annually and allocated monthly on the basis of gross costs to all entities or responsibility segments which produce a product or service.

c. The calculation shall be based on an appropriate statistical method determined by the administration CFO or the senior executive of the administration or office which has no CFO, who will rely on the input of the facility or the regional senior executive of regions which have no CFO, with the concurrence of the VA CFO.

8. INTERNAL OVERHEAD

a. The criteria for a service, division, office, or other organization being classed as internal overhead are as follows:

(1) The entity produces no distinct, billable product or service for any person, service, or organization to which its expenditures could be directly attached;

(2) The entity in the normal course of business supports responsibility segments which in turn support the production of or produce products or services;

(3) The entity is organizationally a part of the same unit which produces the products and/or services (such as a VAMC or a regional office).

b. Internal overhead entities will cost resources expended in support of the entity of which it is a part. Internal overhead is calculated annually on the basis of gross costs to all entities or responsibility segments which produce a product or service.

c. The calculation shall be based on an appropriate statistical method(s) (such as FTE, dollars or square feet) determined by the administration CFO or the senior executive of the administration or office which has no CFO, who will rely on the input of the facility senior executives, with the concurrence of the VA CFO.

9. OVERHEAD COST ALLOCATION IN SPECIAL CIRCUMSTANCES

a. When an organization classed as an overhead entity performs and/or produces a distinct, billable service and/or product at the request of one, several, or a group of VA organizations, offices, services, or divisions; and if the requester(s) is not the sole entity to which the overhead organization assigns its costs (as in the case of VACO Pharmacy Service and field Pharmacy Services), then all costs associated with producing that product and/or performing that service will be charged directly to the requesting entity(ies). The costs charged directly to the requesting entity will be reduced from the total gross expenditures of the entity which performed the service and/or produced the product prior to the expenditures of the performing entity being allocated. For example, Information Resource Management (IRM) may be requested by a VA entity such as VACO Pharmacy Service, to create or enhance a computer program which will be used only by pharmacy services. In such a case, the cost of fulfilling this request should be allocated to the requester (in this example VACO Pharmacy Service), and not allocated to all VA entities.

b. When an overhead office or entity falls into more than one of the above categories, that office or entity shall allocate its costs as fairly and accurately as is feasible and possible. For example, the Office of the Inspector General (IG) falls into both the VA Wide National Overhead and Administrative Overhead categories. Some of its functions and personnel are dedicated to one particular administration, while others benefit all VA. Those costs attributable to a specific administration, organization, or office should be allocated to that administration, organization, or office.

c. When an overhead entity as a part of its managerial or functional capacity has within it a responsibility segment which produces a product or service, the cost of providing that

product and/or service shall be attached to the product and/or service or otherwise passed on to the entities benefiting from or using that product and/or service.

10. REVIEW AND VERIFICATION OF OVERHEAD: The review of overhead designations for VA entities and responsibility centers and the verifying of overhead cost allocations, including methodology, amount, and timelines, will be made by the VA CFO.

SECTION E. CHARGES

1. BASIC PRINCIPLES

a. Costs incurred by VA in fulfillment of its missions are attached to the products or services provided (See Section B: Costs and Section C: Cost Elements). Once known, those costs could become the basis for amounts charged to the entity receiving those goods or services.

b. VA must develop charges based on cost and price analyses. Additionally, as shown in Section A, (VA Handbook 4560.1) the CFO Act, as well as U.S.C. Title 38, OMB Circulars, and GAO Decisions and Guidelines, it is incumbent upon VA to calculate and allocate all costs incurred by the acquisition or production, management, and delivery of a product or service. The benefits of doing so go beyond the cost recovery aspect. Accurate, timely, and useful cost information is essential to effectively manage VA's resources. Furthermore, having access to such information positions VA to quickly respond to changes in health care delivery and funding. The development of charges is central to any VA cost recovery effort, whether it be directed at the private sector or other VA or Governmental entities.

c. The procedure of a VA entity costing a good or service then charging the entity which benefits from or uses that good or service is referred to as Inter-Entity Costs. The value of these costs will provide that no one VA entity remains responsible for funding a product or service that may be utilized by many VA or other Governmental entities. For example, a central dental laboratory located on the grounds of one VA medical center yet shared by many VA medical centers and out-patient clinics is funded through the host VA medical center. As the Government moves toward a more fiscally responsible posture as evidenced under the charges defined by the CFO Act, such fiscal burdens must be removed from host sites and shared by all entities receiving the good or service.

d. Entities such as the central dental laboratory used in the example above should operate in a business-like manner which ensures that the charges associated with their products cover the costs of generating, managing, and delivering the products, and that all entities using the products fairly and equitably share in the costs of providing those products. Additionally, this methodology encourages management involvement and decision making concerning both the product or service and VA's role in providing that product or service, allowing managers to make more informed decisions in the areas of not only materiel and personnel management but also contracting, both within and outside VA.

Additionally, offices or entities such as Congressional Affairs and the Inspector General which are classified as national overhead costs (see Section D: Overhead) are fairly and appropriately charged to the departments or entities which use or benefit from the products or services rendered by those offices or entities.

2. COST VS CHARGES

a. "Cost" can be defined as the actual, total dollar amount expended to produce, manage, and deliver a product or service. Cost can vary on any given day as demands for a product or service fluctuate. For example, on Monday a VAMC technician performs 8 chest x-rays and on Tuesday performs 6. The film and supplies expended for each set of x-rays will be \$5. Monday the costs per set of chest x-rays is \$42.50 (\$300 divided by 8 plus \$5), while on Tuesday the costs per set of chest x-rays is \$55 (\$300 divided by 6 plus \$5).

b. "Average Cost" is the costs of providing a good or service averaged over time. Often used interchangeably with "cost," the averaging of costs allows managers to determine the cost of the typical product or service on a typical day or other applicable time frame. (Using the example above, a manager might look at six month's or a year's worth of data on the X-ray room's costs and usage to determine an average cost per chest X-ray set.) Averaging is most effective when an entity delivers a fairly substantial number of the same product or service on a regular basis. The greater the number of items being averaged, the more accurate the average cost.

c. Charges are derived from costs, and represent the value of the product or service being offered, taking into account any irregularities in day to day or week to week product or service costs and any other factors which would cause cost variances. This value or charge is determined by the entity which produces, manages, and delivers the product or service.

d. Price is the value of a product or service as viewed from the customer's point of view. A customer or consumer is most often not aware of the cost elements which go into the production, management, or delivery of a product or service. When a customer compares price, he or she is comparing an aggregate of the costs, plus any other considerations such as profit, risk, or reserve values.

3. DEVELOPMENT OF CHARGES

a. The development of charges is the responsibility of the VA entity which procures, produces, provides, or otherwise offers the product or service, or product or service line. The charges must cover the costs to the Government for the procurement, development, construction, manufacture, management, delivery, and any other expenses associated with the product(s) or service(s), including but not restricted to local, regional, and national overhead costs.

b. Charges shall be subject to an approval process which shall include but not be limited to the manager of the entity offering the product or service, the appropriate departmental or administration CFO or the senior executive of the administration or office which has no CFO.

c. All charges are subject to biennial review by the VA CFO in the person of the Office of Financial Policy (047G), Cost Accounting and Medical Rates Division (047GC2). The documentation reviewed by the VA CFO shall include but not be limited to:

(1) A full description of the product or service;

(2) A full disclosure of the methodology used to cost the product(s) or service(s) and the time, services, and dollars, both direct and indirect, used to arrive at the product(s) or service(s) costs;

(3) A description of all the products or services offered by an entity (including the product or service being approved) written in such a way that approving officials can determine the scope of the entity's charges and the size or scope of the product(s) or service(s) being approved in relation to the entity's entire product or service line.

d. The policies now in place dictating terms and payment methodologies adopted by VA entities shall be used to obligate, record, transfer, or otherwise account for and pay charges, including but not limited to the laws, regulations, policies, and procedures associated with procurement practices (see the Federal Acquisition Regulations (FAR) and VA Acquisition Regulations (VAAR)). If no methodology exists, one shall be developed by the entity (administration, staff office, etc.) and subject to the normal approval processes, which shall include but not be limited to the entity's manager and/or director, the administration or office CFO (if the entity has a CFO), the senior executive, and the VA CFO.

4. START-UP AND PARTIAL DELIVERY CHARGES

a. Costs associated with the start-up of a project shall be fully charged or allocated, regardless of the outcome of the project. For example, if National Cemetery System (NCS) were to request that IRM create a program for them, then later decides to purchase an off the shelf program, any costs incurred by IRM, including equipment and labor, expended on the behalf of NCS up to that point shall be charged to NCS.

b. Costs associated with the production of a product or delivery of a service shall be fully charged or allocated, regardless of the outcome of the product or service delivery. These costs can be either passed on to the customer directly (through charges) or indirectly (as an expense of doing business which is calculated as part of the entity's product or service cost). This includes but is not limited to cancellation or stop production fees. These fees can be charged directly to the customer when the following prevail:

(1) The conditions concerning the assessment of those charges are clear and the customer is made aware of the conditions and charges in writing, in advance;

(2) The charges cover the costs of the services rendered.

GLOSSARY

Activity Based Costing - A cost accounting method that measures the cost and performance of process related activities and cost objects. It assigns cost to cost objects, such as products or customers, based on their use of the activities. It also recognizes the casual relationship of cost drivers to activities.

Administration - One of the three VA administrations: Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), and National Cemetery System (NCS).

Allocated - Distributed among users.

Calculated - Worked out by mathematical functions.

Capacity - The output capability of an organization when it fully utilizes its resources to create the maximum value for customers while generating the minimum amount of waste.

CFO - Chief Financial Officer.

Cost Driver - Any factor that causes change in the cost of an activity or output. For example, the quality of parts received by an activity, or internal review by VA Financial Quality Assurance staff.

Cost Object - An activity, output, or item whose cost is to be measured. A cost object can be an organizational division, a function, task, product, service or customer.

Direct Cost - The cost of resources directly consumed by an activity. Direct costs are assigned to activities by direct tracing units of resources consumed by individual activities or production units. Direct costs are those costs specifically identified with a single cost object.

Direct Overhead Cost - The costs identifiable with several or many cost objects, but not all. Direct overhead costs are incurred because of an existing capacity or functionality but not because of one specific activity.

Entity - Any group separated from others by an official or organizational designation.

Fixed Costs - The costs or expenses that do not vary in the short term with the volume of activity. (non variable, or constant cost)

Full Cost - The sum of all costs required by a cost object including the costs of activities performed by other entities regardless of funding sources.

Good(s) - see Products

Inter-Entity - A term meaning between or among different federal reporting entities. It commonly refers to activities or costs between two or more agencies, departments, or bureaus.

NCS - National Cemetery System. (Also see: Administration)

Normal Capacity - The average total of production/service units that a responsibility segment produces over an extended period of time.

Office - A VA organizational unit which does not report to or otherwise function under one of the three VA administrations (VHA, VBA, and NCS). Examples: Office of Management and Office of Inspector General.

Overhead - Costs/expenses (as rent, insurance, or heating) not chargeable to a particular part of the product or service being produced by an organization. Costs that are outside the control of the department managers.

Product(s) - Any discrete, traceable or measurable goods or services that are provided to a customer.

Production Unit - A function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the costs of processes, products, jobs, capitalized projects, etc.

Readiness Capacity - Capacity that is not used in normal operations but is maintained for war or emergency readiness.

Responsibility Center - An organizational unit headed by a manager or group of managers who are responsible for its activities. Responsibility centers can be measured as revenue centers (accountable for revenue/sales), cost centers (accountable for costs/expenses), profit centers (accountable for revenues and costs), or investment centers (accountable for investments, revenues, and costs).

Responsibility Segment - A significant organizational, operational, functional, or process component which has the following characteristics: (a) its manager reports to the entity's top management; (b) it is responsible for carrying out a mission, performing a line of activities or services, or producing one or a group of products; and (c) for financial reporting and cost management purposes, its resources and results of operations can be clearly distinguished, physically and operationally, from those of other segments of the entity..

Service(s) - An intangible product/task which tends to be rendered directly to or at the request of a customer. (Also see: Product(s))

Standard Costing - A costing method which attaches costs based upon reasonable estimations or cost studies to include the means of budgeted rates rather than actual costs incurred.

Support Costs - The costs of activities that are not directly related or associated to the production of a product or service. (eg. automation support, communication, postage, engineering and purchasing).

Value Added Activity - that contribute to customer value or satisfaction of an organizational need. Reflects the belief that the activity cannot be eliminated without the reduction of the, responsiveness and quality of output required by the customer of organizational structure.

Variable Cost - The costs that varies with changes in the level of an activity when other factors are held constant. The costs of material handling to an activity, for example, varies according to the number of material deliveries and pickups to and from that activity.

Variance - The degree of change or divergence from the desired characteristic or state of productivity.

VBA - Veterans Benefits Administration. (Also see: Administration)

VHA - Veterans Health Administration. (Also see: Administration)

Volunteer - A private citizen not employed or paid by the VA who provides value added activity which contributes to customer value or satisfies an organizational need. This would include an individual who performs a service which would otherwise have to be provided by a paid employee and would continue to be required even if the volunteer's services were no longer available.